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C O N F I D E N T I A L SECTION 01 OF 03 MOSCOW 003649

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E.O. 12958: DECL: 11/21/2018
TAGS: [EPET](#) [ENRG](#) [ECON](#) [PREL](#) [RS](#)
SUBJECT: WILL RUSSIA JOIN OPEC?

REF: A. MOSCOW 2774
[1](#)B. MOSCOW 1295

Classified By: DCM Eric S. Rubin for Reasons 1.4 (b/d)

SUMMARY

[1](#)1. (C) President Medvedev recently fed speculation about Russia's intentions to cooperate with or join OPEC, telling the press on December 11 that Russia "must defend" higher oil prices, including by reducing oil production and, possibly, joining "organizations of producers." Most Moscow-based analysts dismissed the possibility of Russia formally joining OPEC and giving up its sector independence. They also pointed to the legal and technical hurdles production cuts would face: much of the industry is nominally in private hands and Russia's oil fields could not be easily shut off (or brought back online).

[1](#)2. (C) However, these same analysts said the GOR could take credit for lower Russian production by continuing its current policies, especially its onerous tax regime, which has already lead to declining production in 2008, with greater losses forecast for 2009. In that regard, we believe the most likely scenario for the upcoming OPEC meeting in Algeria is that Russia will announce some type of informal cooperation with OPEC, commit to reducing production by up to a few hundred thousand barrels per day (bpd), and "fulfill" that obligation by doing nothing to reverse the projected declines in the coming year. End summary.

RUSSIA FLIRTS WITH OPEC

[1](#)3. (C) In a departure from a past insistence on Russian independence with regard to oil policy, Russian leaders have recently made various statements with regard to "cooperating" with OPEC. Whether serious or aimed merely at raising uncertainty in order to spook markets toward higher oil prices, President Medvedev on December 11 went as far as suggesting to the press that Russia should consider joining "organizations of producers" in an effort to "defend" higher oil prices, which he admitted are critical to the Russian economy.

[1](#)4. (C) Earlier, on September 9, Deputy Premier Igor Sechin, overseer of Russia's energy sector and policies, attended an OPEC meeting in Vienna, reportedly agreeing to "share

information" with the cartel. Energy Minister Sergey Shmatko said on December 10 that Russia expects OPEC members to reduce production significantly at the upcoming meetings on December 17 in Algeria. He added that Russia will present "concrete proposals" at the meetings regarding its own posture.

BUT UNLIKELY TO JOIN

15. (C) Despite this recent rhetoric by GOR leaders and the many high-level meetings between GOR and OPEC representatives (ref A), most analysts don't believe Russia would go so far as to formally join OPEC. Joining OPEC could result in an intolerable loss of independence for a Russia that prides itself on control over its natural resources and over decisions regarding the all-important energy sector. Furthermore, Russia's oil sector, unlike in other OPEC members, is not nationalized. More than half of production is nominally in private hands, albeit under indirect Kremlin influence.

16. (C) Vladimir Konovalov, head of the Petroleum Advisory Forum, the association of major Western oil companies in Russia, told us December 12 that Medvedev's words are likely just rhetoric, said with the aim of buttressing oil prices, but without any intention of a formal commitment to become an OPEC member. Analysts from several investment banks echoed similar sentiments in their daily newsletters or were quoted in the press with similar analyses, noting Russia's long-held

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position of the importance of its independence in the oil market. (N.B. If Russia is planning to join OPEC, it must be news to the Algerian Embassy, which called us on December 16 to ask if we had an updated phone number for the Russian Ministry of Energy as they needed to call the Ministry to discuss the upcoming visit.)

FORMAL PRODUCTION CUTS ALSO UNLIKELY

17. (C) Even if Russia decided to cooperate with OPEC on a production cut, the question remains as to the mechanics of implementing such a directive in Russia. The possibilities include "voluntary" cooperation by all Russian producers -- a cartel within a cartel -- or "technical" restrictions on the part of Transneft, the state-owned Russian oil pipeline monopoly. Smith agreed that if the GOR were to decide on a formal policy of lower production (which would be a break from numerous public calls by the highest levels of the GOR for increased Russian production), they would have to rely, in the short-term, on "informal measures," suggesting political pressure or administrative restrictions.

18. (C) Another hurdle to production cuts is the physical and technical limitations of the Russian industry. Unlike Saudi Arabia, for example, Russian oil production cannot be easily ramped up or scaled down. There is no "spare production capacity." As one oil analyst recently wrote, many Russian wells in West Siberia (the main producing region) cannot easily produce again once they are shut off. A GOR mandate to curtail production would not easily be reversed if more production was again desired given different economic/financial circumstances.

HOW RUSSIA COULD "COOPERATE") BY DOING NOTHING

19. (C) There may very well be good reason, however, for Russia to "cooperate" with OPEC. Ron Smith, chief strategist at Alfa Banks, shared with us on December 12 an internal analysis demonstrating large potential financial gains to the

GOR under a scenario of coordinated production cuts resulting in substantially higher oil prices. Other analysts are more skeptical, noting individual OPEC members's track record of failing to follow through on production cuts. In addition, higher prices that result from restricting supplies might cause demand to fall even further, reducing sales and revenue.

¶10. (C) A widely held view among energy sector watchers in Russia is that the mechanism by which Russia would contribute to an OPEC production cut would be to do nothing, especially to its oil tax policy that retards upstream investments (ref B). This view is supported by Chevron Russia President Darrell Cordry, who opined that Russia may just be going along with OPEC as means of disguising the current decline in production as a deliberate government-imposed reduction. Due largely to an onerous tax regime that imposes severe disincentives to investment in new production, Russian oil production will decline slightly in 2008 for the first time in nearly a decade. Production is expected to decline further in 2009, perhaps by up to 5%, or approximately 500,000 barrels.

¶11. (C) Konovalov told us he has long-believed the GOR's reluctance to move forward reform of the tax structure -- toward a system based on profits instead of production -- was part of a deliberate plan to keep a lid on Russian production in order to support higher global oil prices. He said cooperation with OPEC "will now give them cover" to do what the GOR wanted to do all along, which is to continue rent-seeking behavior in the sector through high, even confiscatory taxes on the sector.

¶12. (C) Rosneft Vice President for Finance, Peter O'Brien (strictly protect), also thought delaying tax reform would amount to deliberate action to lower potential production in the medium-term. He told us December 14 that the GOR had been very close to implementing a new tax regime on the oil sector, but that it will now delay such action as its

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contribution to proposed OPEC production cuts. He said if the GOR agrees with OPEC to cut production, it would voluntarily delay projected future production increases by holding back on planned tax cuts for the oil sector. (Note: Sechin, who will head the Russian delegation to the OPEC meetings in Algeria, is also Rosneft's Chairman. End note.)

COMMENT

¶13. (C) We believe the GOR will agree in Algeria to "reduce" Russian oil production by a few hundred thousand barrels in 2009, a meaningless commitment since it is the probable outcome regardless of any specific GOR action related to OPEC. However, this will probably be touted by the GOR, OPEC, and many watchers as signaling a new era of Russian cooperation with OPEC, and could result (depending on the size of the announced OPEC cuts) in a temporary spike in crude oil prices.

¶14. (C) The impact, however, will be more psychological than real. The supply and demand picture, and hence the global price, will not be altered by Russia's announcement (and maybe not by OPEC's according to the analysts with whom we talked). Prices will likely continue to trend downward absent a recovery in global demand or an unexpectedly large and enforced OPEC cut. As to Russia's formally joining OPEC, we also think it unlikely. That said, we add a caveat Konovalov used with us -- we wouldn't bet too much money on that assessment.

BEYRLE